



## THE OECD'S CONQUEST OF THE UNITED STATES Understanding the Costs and Consequences of the BEPS Project and Tax Harmonization

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The system for international corporate income taxation is at risk of losing its most valuable feature—diversity and competition. The Base Erosion and Profit Shifting (BEPS) Project of the Organisation for Economic Co-operation and Development (OECD) attempts to change the international tax system by transferring control of corporate taxation from individual nations to an international body. This shift favors consolidated and uniform tax rules but sacrifices compliance efficiency, taxpayer rights, and nations' ability to set the tax policies best suited to their populations.

A new study from the Mercatus Center at George Mason University explains key features of the international corporate tax system, the changes the OECD wants to make, and the potentially far-reaching consequences of those changes. The study then provides recommendations to improve corporate taxation without compromising state sovereignty or taxpayer rights.

To read this study in its entirety and learn more about its authors, [Jason J. Fichtner](#) and [Adam N. Michel](#), please see "[The OECD's Conquest of the United States: Understanding the Costs and Consequences of the BEPS Project and Tax Harmonization](#)."

### KEY POINTS

- The BEPS Project is intended to simplify and coordinate tax reporting, increase tax transparency, and increase corporate tax revenue by closing loopholes.
- However, the BEPS Project's proposal to further centralize the control of taxation would infringe on national sovereignty and taxpayer rights and impose onerous and costly compliance requirements—and would likely fail to meaningfully increase corporate tax revenues.
- Ideally, the United States should abandon corporate taxation altogether because it is inefficient and discourages the corporate investment that produces economic growth.

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- Such a shift is probably not politically viable in the short term. However, second-best reforms to the US corporate tax system include ending worldwide taxation and moving toward a territorial tax system, allowing full and immediate expensing of business investments, and lowering the corporate tax rate, which is currently the highest in the OECD.

## BACKGROUND

Corporate tax codes are highly complex and are designed to accomplish a herculean task—fairly and efficiently collecting taxes from business networks across hundreds of countries. To the extent that an international tax system exists, each individual country’s tax code is linked to others through hundreds of bilateral tax treaties. These complex treaties facilitate communication between international tax codes, which is increasingly necessary as businesses expand beyond the borders of their home countries.

International tax competition aims to attract economic activity by reducing the rate at which profits are taxed. If a firm moves from a high-tax country to a low-tax country, the high-tax country’s corporate tax base will shrink—it will face “base erosion.” In other circumstances, a business might shift profits rather than physical property to lower its tax burden, a process known as “profit shifting.”

## THE OECD TAKES ON BASE EROSION AND PROFIT SHIFTING

In 2012 the OECD released a series of reports on the BEPS Project. The reports fail to show any precipitous drop in corporate tax collection as a share of either GDP or total revenue. Despite the lack of evidence that there is a significant problem, the OECD concludes that base erosion and profit shifting are real but that “it is difficult to reach solid conclusions about how much base erosion and profit shifting actually occurs,” given the available data.

The OECD outlined 15 action items and set an expedited two-year timeline for the project’s completion. This study analyzes two of these action items—pertaining to the valuation of intangibles and tax transparency—to consider their impact on multinational firms.

### **Action 8: Globalization and Intangible Property**

The OECD has identified intangible assets such as patents, trademarks, and other intellectual property as key components in international base erosion and profit shifting. Action 8 aims to align value creation with the accounting protocols that govern the valuation of intangible assets moving across national borders. The OECD report covers the minutia necessary for tax administrators to comply with the goal of sourcing income to measurable economic activity.

However, the OECD’s project continually bumps up against the fundamental issues intrinsic to the task of taxing global firms. Intangibles are by their very nature fungible, transcending the artificial boundaries of the nation-state. These knowledge-based assets can be difficult to price because there are no comparable products and they are often developed through a diffuse global

production chain. The OECD cannot remove the incredible complexities of tracing expenses to income-generating intangible assets.

### **Action 13: Costly Transparency and the Dark Side of Disclosure**

Action 13 requires large multinational enterprises to provide detailed annual reports of their activities in each jurisdiction where they do business, known as “country-by-country reporting.” The goal of this new regime is to make multinational firms more honest in their reporting and to help tax administrators root out profit shifting from high- to low-tax jurisdictions. However, collecting and reporting this information would likely be incredibly costly for companies as it represents a substantial change in how businesses currently report tax information.

There is also concern that the new country-by-country reports will be used to justify frivolous audits and thus will increase real profit shifting. There is a widely held fear that tax administrators, in attempts to expand their tax base, will use this information to pressure companies to align taxes with sales, employment, or asset locations. A World Bank working paper finds that this type of reporting transparency exposes firms to “a significantly higher level of corruption.”

Data security is also an issue. Assembling a new, centralized database of highly sensitive corporate financial information increases the vulnerability of proprietary business data. It would take just one breach of the system in any one of the party jurisdictions for all the information to be exposed. Furthermore, governments are likely to share data which may compromise trade secrets. While the proposed multilateral treaty under the BEPS Project includes a confidentiality clause, this protection would be functionally meaningless because most countries do not consult taxpayers when an information request is made. Without consultation, it is impossible for tax officials to know what information is or is not a trade secret.

## THE HARMFUL COSTS OF GLOBAL TAX CONSOLIDATION

The type of tax competition the OECD is attempting to stop is a fundamental characteristic of jurisdictional diversity. Countries compete on innumerable margins for capital investments. The United States offers a highly educated workforce and modern infrastructure. Developing countries compete by having less expensive labor and less intrusive regulations. Countries compete for foreign investments on any number of margins and it seems peculiar that governments would not be allowed to compete through their tax codes.

Any tax system can work to fully tax all corporate profits if tax rules are centralized at an international level. However, it is evident that global jurisdictional diversity has benefits that accrue outside the tax code, resulting in better governance. No matter what method is proposed for global centralization, it should be resisted because the costs of centralization are often unseen and greater than the benefits.

## CONCLUSION AND POLICY PROPOSALS

There is near-universal agreement that the corporate income tax is severely flawed, and the BEPS Project highlights the need for a new approach. Instead of trying to eliminate tax competition, the United States should reform its own tax code by considering alternatives to the corporate income tax. The corporate tax is inefficient because it double-taxes income, penalizes business activity, and requires onerous and costly regulations.

While corporate income taxes are fundamentally flawed, political constraints will make repealing the tax an infeasible policy option in the short term. There are, however, several reforms Congress could enact to make the US corporate tax system more competitive.

- *End worldwide taxation.* The United States is currently one of just six OECD countries that still tax worldwide income. Worldwide taxation penalizes companies for bringing foreign profits home and puts US firms at a competitive disadvantage.
- *Allow full expensing.* Allowing corporations to fully expense all purchases at the time they are made would stimulate investment, create jobs, and expand the economy.
- *Lower the corporate tax rate.* The United States must lower its national corporate tax rate to 20 percent or below. The United States has the single highest combined corporate tax rate in the OECD, a situation that drives companies offshore and hinders growth.